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Argued by

ARCHIBALD PALMER.

Supreme Court of the United States

OCTOBER TERM 1934.

No. 625.

REALTY ASSOCIATES SECURITIES CORPORATION and REALTY ASSOCIATES, INC.,

Petitioners,

against

EUGENE F. O'CONNOR, JR., FRED L. GROSS, HOMER E. PALMER et al., ALMON G. RASQUIN, ELIZA B. CARMAN et al., BONDHOLDERS' COMMITTEE of which WILLIAM E. KENNEDDY, JR., is Chairman, MANUFACTURERS TRUST COMPANY, and BONDHOLDERS' COMMITTEE of which FREDERICK S. ROBINSON is Chairman.

BRIEF OF APPELLEES ELIZA B. CARMAN ET AL.

The above-entitled proceeding is before this Court on a certiorari heretofore granted (R. p. 167) to review a decree of the United States Circuit Court of Appeals for the Second Circuit (Judge A. N. HAND dissenting with opinion—R. p. 161), which was made on the 10th day of December, 1934 (R. p. 151).

The decree of the Circuit Court of Appeals modified the order of the United States District Court for the Eastern District of New York (R. p. 85) confirming a composition in bankruptcy. The said decree increased the compensation of Referee Eugene F. O'Connor, as referee in bankruptcy, from $24,064.87, provided for in the order of the District Court of April 6, 1934, to the sum of $65,040.19.

Opinions of the Courts Below.

The opinion of the District Court (R. p. 102) is reported in 6 Fed. Supp. 549. The prevailing opinion of the Circuit Court of Appeals (R. p. 152) and the dissenting opinion of Judge A. N. HAND (R. p. 161) are reported in 74 F. (2d) 61.

The Issue.

The statutory provision for compensation to a referee in bankruptcy is stated in Section 40 of the Bankruptcy Act (11 U. S. C. A., Sec. 68) as follows:

> "(a) Referees shall receive as full compensation for their services • • • one-half of one per centum on the amount to be paid to creditors upon the confirmation of a composition."

By the terms of the composition offer the creditors received 15 percent of their claims in cash (namely $2,091,129.04) and were permitted to retain as evidence of the remaining 85 percent of their claims the existing outstanding bonds of the bankrupt upon which their claims were based.

Of the claims filed against the bankrupt in the sum of $13,008,038.30 (R. p. 65), the sum of $12,631,949.68 was based upon bonds issued under three indentures between the bankrupt and the Manufacturers Trust Company as Trustee, and guaranteed by New York Investors, Inc. (R. pp. 7, 23).

Of the other claims filed aggregating the sum of $208,133.90 (R. p. 106), a claim in the sum of $207,583.95 was the subject of pending objections (R. p. 90).

The referee contended that his commissions of one-half of one per centum should be computed on the basis that creditors are receiving the entire sum of $13,008,038.30, the full amount of the claims filed and allowed or scheduled.

The District Court determined (based upon a finding by the District Court of the market value of the bonds retained by the creditors) that "the amount to be paid to creditors upon the confirmation of said composition" was $4,812,974.17, and awarded the referee one-half of one per centum on this amount, namely, $24,064.87 (R. p. 97).

It is the contention of the appellees that the compensation which the referee should receive should be fixed on the amount actually paid to creditors upon the confirmation of the composition.

Statement of Facts.

This is a bankruptcy proceeding. The Realty Associates Securities Corporation filed a voluntary petition in bankruptcy on July 10, 1933 (R. p. 2). On the same day receivers were duly appointed by order of the District Court (R. p. 2). One of the receivers, Frank Fox, withdrew and resigned as such receiver with permission of the court on January 4, 1934 (R. p. 2). The bankrupt duly made an offer of composition (R. p. 8) to its creditors pursuant to Section 12 of the Bankruptcy Act, and the said offer of composition was accepted by a majority in amount of creditors (R. p. 88).

The total amount of claims approved against the bankrupt estate was $13,008,038.30 (R. p. 65), and with the exception of $208,133.90 were all based upon bonds outstanding under three indentures, to-wit, Realty Associates Securities Corporation and the Manufacturers Trust Company as Trustee, dated July 1, 1925, December 1, 1927, and October 1, 1928, respectively (R. pp. 9-10).

Composition Offer.

The offer of composition provided:

> "The amount to be paid to all creditors * * * shall be fifteen per cent. (15%) of the amount of their

claims as filed and allowed * * *. The remaining eighty-five per cent. (85%) of the amount on which said fifteen per cent. (15%) is computed shall be evidenced by the existing outstanding bonds as reduced and modified as hereinafter provided" (R. p. 9).

The composition further provided for the extension of time for payment of two or three series of bonds to October 1, 1943; the reduction of the rate of interest from six to five percent, payable as earned; the giving of bondholders representation of four directors on the board of twelve; and modifications in the protective covenants affecting the bonds were prescribed (R. pp. 8-27).

The offer also provided that the existing outstanding bonds should be stamped with a notation that they have been reduced and modified (R. p. 11). The composition also provided (R. p. 23) that it "shall be without prejudice to the rights, if any, of holders of such bonds against New York Investors, Inc., arising out of, under or in connection with the guaranty of said bonds by the New York Investors, Inc., and all causes of action, if any, accruing to said bondholders by reason of such guaranty are hereby reserved unto them."

No new bonds or other obligations were issued to evidence the remaining 85 percent.

The referee's report on the composition was made on March 12, 1934 (R. p. 45), and the composition was confirmed by the order of the District Court on April 6, 1934 (R. p. 85).

Referee's Compensation.

The referee contended before the District Court that he was entitled to $65,040.19 as his compensation under Section 40 of the Bankruptcy Act, the same being one-half of one percent of $13,008,038.30, the total amount of claims filed and allowed or scheduled, such contention being upon the theory that the creditors were to be paid one hundred

cents on the dollar upon the confirmation of the composition.

The bankrupt objected to the inclusion, in the sum upon which commissions were to be computed, of any portion of the remaining 85 percent of the claims (15 percent being paid in cash) which were evidenced by the existing bonds as reduced and modified, except that if such existing bonds, which were retained by the creditors after the composition, were to be included at all in the sum upon which the referee's compensation was computed, such bonds should be included only at their market value at the time of the confirmation.

The District Court found that such market value of said bonds after the payment of said 15 percent in cash was 22, or the equivalent of $220 for the 85 percent remaining due upon each $1,000 bond retained by the creditors (R. p. 107).

The District Court held that, although the 85 percent of the old debt persisted undischarged (R. p. 106), it would be unfair to exclude such 85 percent entirely from the computation of commissions, and added the market value of the bonds retained by creditors to the amount actually to be paid to creditors upon the confirmation of the composition (R. p. 110).

The District Court further found that the amount to be paid to creditors upon the confirmation of the composition was $4,812,974.17 (R. p. 97), which amount is made up of the total amount of priority claims, plus the 15 percent in cash on general claims, plus 22 percent (the value of the retained bonds) of such general claims.

This decision of the District Court resulted in fixing the referee's compensation of $24,064.87, which is one-half of one percent of $4,812,974.17 (R. p. 97).

The referee and Fred L. Gross, one of the receivers, whose compensation had been fixed by the District Court at $28,877.84 (R. p. 97), appealed to the Circuit Court of Appeals from that portion of the order confirming the composition which fixed their fees (R. pp. 115-123).

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In holding that the effect of the confirmation of the composition was to destroy the obligation upon bonds which the creditors were permitted to retain pursuant to the offer of composition, and to substitute a new obligation.

(2) In holding that the amount remaining due upon the bonds which the creditors retained constituted any part of "the amount to be paid to creditors upon the confirmation of the composition," and in allowing any commissions to the referee on the amount so remaining due.

Summary of Argument.

I. REFEREE'S COMMISSIONS SHOULD ONLY BE CALCULATED ON AMOUNTS ACTUALLY PAID TO CREDITORS.

II. IT WAS THE INTENTION IN THE OFFER OF COMPOSITION TO PROVIDE ONLY FOR THE SETTLEMENT OF 15 PERCENT. ON THE AMOUNT OF THE CLAIMS OF THE CREDITORS AS PROVED AND ALLOWED, OR SCHEDULED.

Argument.

POINT I.

Referee's commissions should only be calculated on amounts actually paid to creditors.

The language of the Bankruptcy Act is mandatory with regard to compensation which referees shall receive, and it is not proper to calculate the referee's commissions on the total amount of the bankrupt's estate, nor the amount of claims or liabilities scheduled, but only on the amount disbursed to creditors. *Black on Bankruptcy,* 4th Ed., p. 1590; *In re Motridge* (C. C. A. 7), 258 Fed. 229; *In re Philips & McEachin* (C. C. A. 2), 210 Fed. 889.

Section 40 (a) of the Bankruptcy Act (11 U. S. C. A., Sec. 68 [a]) provides:

> "Referees shall receive as full compensation • • • for their services one-half of one per centum on the amount to be paid to creditors upon the confirmation of a composition."

Subdivision 2 of General Order XXXV prescribed by this Court for the enforcement of the Bankruptcy Law provides:

> "The compensation of referees, prescribed by the Act, shall be in full compensation for all services performed by them under the Act, or under these General Orders; • • •."

The statute clearly limits the commissions to one-half of one percent "to be paid to creditors upon the confirmation of the composition." How much was paid to creditors? Paragraphs 3 and 5 of the modified offer of composition (R. pp. 9-10) provided that the "amount to be paid to creditors • • • shall be fifteen percent. (15%) of the amount of their claims • • •." These are the only

provisions in the offer of composition for payment to creditors.

The consideration to be paid by the bankrupt to its creditors, the moneys entitled to priority, and the costs of the proceedings must be deposited in such place as shall have been designated by and subject to the order of the Judge before the application for the confirmation of a composition is filed. *In re Harvey* (D. C. Pa.), 144 Fed. 901; *In re Flynn* (D. C. Mass.), 134 Fed. 145; *Cumberland Glass* v. *DeWitt*, 237 U. S. 447, 454, 35 S. Ct. 636, 59 L. Ed. 1042.

Section 12 (b) of the Bankruptcy Act (11 U. S. C. A., Sec. 30 [b]) provides:

> "An application for the confirmation of a composition may be filed in the court of bankruptcy after, but not before, it has been accepted in writing by a majority in number of all creditors whose claims have been allowed, which number must represent a majority in amount of such claims, and the consideration to be paid by the bankrupt to his creditors, and the money necessary to pay all debts which have priority and the cost of the proceedings, have been deposited in such place as shall be designated by and subject to the order of the judge."

Rule 13 of the Bankruptcy Rules of the District Court of the United States for the Eastern District of New York provides:

> "13. APPLICATION FOR CONFIRMATION OF COMPOSITION.
>
> Application for the confirmation of a composition shall be filed, in all cases, with the clerk of the court, *and the consideration to be paid by the bankrupt to his creditors* and the money necessary to pay all debts which have priority and the costs of the proceedings *shall be deposited with the clerk,* who shall certify the fact to the court, and thereupon a day for the hearing before the judge shall be fixed by the order of the court."

The requirement of this section as to the deposit of money on a composition agreement is imperative, and if it is not complied with, the composition will not be confirmed although the application is not opposed by any creditor. *In re Frear* (D. C. N. Y.), 120 Fed. 978.

What constitutes the consideration to be paid?

It has been held that the consideration to be paid to creditors on the composition in bankruptcy is not necessarily cash, but may be something equivalent to money or convertible into money. *Kinkhead* v. *Bacon* (C. C. A. 6), 230 Fed. 362; *In re Hurst* (C. C. A. Mich.), Fed. Cas. No. 6925.

If the argument that the consideration to be received by the creditors was 100 percent were tenable, why was only the sum of 15 percent required to be deposited to effectuate the terms of the offer? No other bond, undertaking or other evidence of debt was required.

The order of the District Court confirming the decision as modified only required the deposit of 15 percent in cash (R. pp. 94-95). The opinion of the Circuit Court (R. pp. 151-160) and the order for the mandate thereon (R. pp. 164-165) in nowise changed or modified the order of the District Court with regard to the deposit of the "consideration" as required by the Bankruptcy Act.

The notation to be stamped or attached to the "presently outstanding bonds" by the Manufacturers Trust Company with respect to the modification of these bonds as provided for in the offer in nowise altered the legal relationship.

The creditors have the right to waive the actual deposit of the consideration or part thereof, but this must be expressly provided for by the creditors. *Kinkhead* v. *Bacon* (supra).

The creditors did not expressly waive the deposit of any consideration by their acceptance of the offer of composition, nor did the offer of composition provide for the waiver of any deposit of the consideration to make up the difference between the 15 percent in cash payable under the terms of the offer and the 100 percent.

Nevertheless, the sum awarded to the referee was $65,040.19, which is computed on the basis of $13,008,038.30, although $2,091,128.04 was the only amount paid to creditors on confirmation of the composition.

POINT II.

It was the intention in the offer of composition to provide only for the settlement of 15 percent on the amount of the claims of the creditors as proved and allowed, or scheduled.

Both the intention and the effect of the modified offer of composition was to keep alive the old debt, except as modified. Of the total claims filed, scheduled and allowed in the sum of $13,800,038.30 (R. p. 65), claims not based on the presently outstanding bonds were in the sum of $208,133.90 (R. p. 65). The modified offer of composition provides that "The amount to be paid to all creditors whose claims are based on presently outstanding bonds of Realty Associates Securities Corporation, and whose claims have either been filed or allowed or are included in the schedules filed by the bankrupt (claims of such creditors to be stated as of July 10, 1933), shall be fifteen percent. (15%) of the amount of their claims." The remaining 85 percent "shall be evidenced by the existing outstanding bonds as reduced and modified hereinafter" (R. p. 9).

With regard to creditors whose claims are not based on presently outstanding bonds, the modified offer provides for the payment of *"15 percent of the amount of their claims"* and "that such creditors shall also receive presently outstanding bonds now in the treasury of the Realty Associates Securities Corp. issued under the indenture above mentioned * * *."

Thus there is express provision for a settlement in the sum of 15 percent and a continuance of presently existing bonds reduced, however, by the immediate payment of the said sum of 15 percent and modified only insofar as

the reduction in the payment of interest from six to five percent, the extension of the date of maturity of the bonds, and retention of the appointment of four directors of twelve.

The presently outstanding bonds were guaranteed by New York Investors, Inc. (R. p. 23), and it was the intention of the offer not to provide for any new obligation or undertaking so as to prevent the undermining of any rights which the creditors and the presently outstanding bondholders might have had by reason of the guaranty (R. p. 23).

> "10. This composition, including the modification of the presently outstanding bonds and the indentures as hereinabove provided and the detaching of the coupons from the bonds, shall be without prejudice to the rights, if any, of holders of such bonds against New York Investors, Inc., arising out of, under or in connection with the guaranty of said bonds by New York Investors, Inc., and all causes of action, if any, accruing to said bondholders by reason of such guaranty are hereby reserved unto them."

To hold that the offer created a new obligation insofar as the securities are concerned would be a destruction of the guaranty which was intended by the parties to be kept alive, and a deprivation of the valuable rights of the bondholders in the sum of upwards of $12,000,000 by reason thereof.

The offer should be so construed as to give meaning and effect to all of its terms. A construction which gives a reasonable meaning to all of its provisions should be preferred to one which leaves a portion of it useless. *E. I. Dupont DeNemours & Co.* v. *Claiborne-Reno Co.* (C. C. A. 8), 64 F. (2d) 224, cert. den. 290 U. S. 646.

In *Kinkhead* v. *Bacon & Sons* (supra) (R. pp. 156, 158, 159), the court dealt with the waiver of the deposit by cash of creditors to be paid on the composition. The court stated that the waiver of the deposit of cash was

not a waiver of the payment by the bankrupt to the creditors of the amount agreed to be paid under the composition, the creditors having accepted in express terms "the offer of composition at 35 percent payable in cash."

In the instant case, the modified offer of composition expressly provided for 15 percent cash settlement and the creditors retained their rights in the "presently outstanding bonds" subject to modification. The District Judge held (R. p. 106) that 85 percent of the old debt persists, that it was not discharged, but survived in a modified form (R. p. 107). The court stated (6 Fed. Supp. 549 at 551) (R. p. 107):

> "To assert that acceptance of an offer of composition wipes out an old debt, because in terms it has been but modified, is to deal with verbal niceties which in no respect appeals to the conscience of the court."

In *In re Batterman Co.* (C. C. A. 2), 231 Fed. 699 (R. pp. 158-159), there was an offer of composition by the bankrupt of 65 percent in cash. Some of the creditors agreed to waive the deposit of cash and accept an alternative offer of 15 percent in cash paid by H. B. Claflin Corporation and 85 percent in notes made by another corporation, the Mercantile Corporation.

Judge AUGUSTUS N. HAND, recognizing the inapplicability of the *Batterman* case to the instant case, in his dissenting opinion (74 F. [2d] 61 [C. C. A. 2]) (R. p. 162) stated:

> "Our decision in In re Batterman, 231 F. 699, is thought to be contra, but I cannot see that it is opposed to my view. In that case a composition was offered by the bankrupt-corporation of 65 per cent in cash. Some of the creditors offered to waive a deposit of cash and to take instead 15 per cent in cash furnished by H. B. Claflin Corporation and 85 percent in notes of another company indorsed by Claflin. We affirmed the court below in holding that

> the alternative offer made in consideration of the waiver of the deposit of 65 per cent in cash was to be considered as the equivalent of the latter amount and allowed the referee commissions as though the 65 per cent in cash had been deposited. The decision seems in accord with that of Judge Galston in the case at bar for it involved valuing the 15 per cent of cash and the 85 per cent in notes at 65 per cent in cash and calculating the commissions on the latter sum."

As long as the Bankruptcy Act is complied with the bankrupt and its creditors had a right to enter into an agreement on what the creditors should actually receive under the composition and what indebtedness should be renewed or remain in effect after the confirmation of the composition. *Equitable Holding Corp.* v. *Chas. L. Woody, Jr.* (C. C. A. 2), 63 F. (2d) 751; *In re Malkan* (C. C. A. 2), 261 Fed. 894.

The portion of the debt renewed by agreement with the bankrupt, or which, by agreement, was to remain in effect after the confirmation of the composition, could not be considered as part of the consideration to be paid to creditors.

In the case at bar, the District Judge said (6 Fed. Supp. 549 at 551):

> "However one may view the transaction, eighty-five percent of the old debt persists. It is not discharged."

See also *In re Chimovitz* (D. C. Mich.), 30 F. (2d) 114.

The obligations under a composition are to be determined from the language used as in any other contract. *Equitable Holding Corp.* v. *Charles L. Woody, Jr.* (supra).

In *Myers* v. *International Trust Co.*, 273 U. S. 380 at 383, Mr. Justice SANFORD said:

> "The question must be answered in the light of the principle stated by the Supreme Judicial Court,

> that a 'composition partakes of the nature of a contract.' * * *. A composition is 'a settlement of the bankrupt with his creditors'—in a measure superseding and outside of the bankruptcy proceedings—which originates in a voluntary offer by the bankrupt and results, in the main, from the voluntary acceptance by his creditors; that the respective rights of the bankrupt and the creditors are fixed by the terms of the offer; and that upon the confirmation of the composition they get what they 'bargained for', and no more."

See also *Nassau Works* v. *Brightwood Co.*, 265 U. S. 269, 271, 273, 274, 44 S. Ct. 506, 68 L. Ed. 1013; *Cumberland Glass Co.* v. *DeWitt*, 237 U. S. 447, 453, 454, 35 S. Ct. 636, 59 L. Ed. 1042; *In re Lane* (D. C. Mass.), 125 Fed. 772.

If the composition is in the nature of a contract, and as long as the Bankruptcy Act has been complied with, the bankrupt was justified in providing for a payment of only 15 percent in cash, and in waiving its right to be discharged of the remainder of the debt by agreeing to its continuance.

The order confirming the composition clearly indicates that the debt of the outstanding bonds continues. It provides in part (R. pp. 92-93):

> "Ordered (2), that Realty Associates Securities Corporation be and it hereby is discharged of all its debts other than such debts as are based upon such proportion of the existing bonds of Realty Associates Securities Corporation as continue and remain in existence as reduced and modified pursuant to the terms of said offer of composition as so modified."

This provision clearly excepts the bonds from the discharge effected by the acceptance and confirmation of the offer of composition.

The order confirming the composition relates back to the inception of the proceedings, and does not bar an

action thereafter brought to collect an antecedent debt revived by a new promise made after the commencement of bankruptcy proceedings. *Schuman Bros.* v. *First Nat'l Bank,* 112 Okla. 192, 240 Pac. 646.

The decision in *Zavelo* v. *Reeves,* 227 U. S. 625, 33 S. Ct. 366, 57 L. Ed. 676, is analogous to the case at bar. Plaintiffs were creditors of the defendant who was adjudicated a bankrupt. An offer of composition made by the defendant was confirmed by the District Court. Plaintiffs had accepted an offer of composition and were paid a dividend thereon. The claim which was sued on was part of and included in the claim on which the dividend was paid. Plaintiffs alleged that the defendant promised that, if they would lend him $500 for use in paying the consideration of the composition with his creditors, upon the confirmation of the composition he would pay the plaintiffs the balance of their claim after deducting therefrom the plaintiffs' share of the consideration of the composition. This action was brought to recover the difference between the original claim and the dividend received on the confirmation of the composition. The court held in favor of the plaintiffs. The court, in its opinion, stated:

> "It is contended as to both replications that although a debt barred by discharge in bankruptcy may be revived by a new promise made after the discharge, this cannot be done by a new promise made in the interim between the adjudication and the discharge.
>
> It is settled, however, that a discharge, while releasing the bankrupt from legal liability to pay a debt that was provable in the bankruptcy, leaves him under a moral obligation that is sufficient to support a new promise to pay the debt. And in reason, as well as by the greater weight of authority, the date of the new promise is immaterial. The theory is that the discharge destroys the remedy but not the indebtedness; that, generally speaking, it relates to the inception of the proceedings, and

the transfer of the bankrupt's estate for the benefit of creditors takes effect as of the same time; that the bankrupt becomes a free man from the time to which the discharge relates, and is as competent to bind himself by a promise to pay an antecedent obligation, which otherwise would not be actionable because of the discharge, as he is to enter into any new engagement. And so, under other bankrupt acts, it has been commonly held that a promise to pay a provable debt, notwithstanding the discharge, is as effectual when made after the filing of the petition and before the discharge as if made after the discharge. Kirkpatrick v. Tattersall, 13 M. & W. 766; Otis v. Gazlin, 31 Maine 567; Hornthal v. McRae, 67 Nor. Car. 21; Fraley v. Kelley, 67 Nor. Car. 78; Hill v. Trainer, 49 Wisconsin 537; Knapp v. Hoyt, 57 Iowa 591, 42 Am. Rep. 50; Lanagin v. Nowland, 44 Arkansas 84; Wiggin v. Hodgdon, 63 N. H. 39; Griel v. Solomon, 82 Alabama 85; Jersey City Ins. Co. v. Archer, 122 N. Y. 376.

Our attention is not called to any decision in point arising under the present Bankruptcy Act; but we deem it clear that the same rule should be applied."

CONCLUSION.

It is respectfully submitted that the decree of the Circuit Court of Appeals should be reversed, and that the order of the District Court be affirmed.

Dated, New York, March 25, 1935.

ARCHIBALD PALMER,
Counsel for Eliza B. Carman et al.